

Snapchat (SNAP)

Attractive

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SNAP 4Q EPS on Deck; Can the 2018 Turnaround Story Manifest?

Next week SNAP will be reporting its 4Q results with the Street anticipating more pain could be ahead on DAU, ARPU, and underlying business trends as the company is going through a major transition on its app redesign and business overhaul. The Street is forecasting total revenues of \$253 million and pro forma EPS of (\$0.16) for the quarter, which represents 50% YoY growth and speaks to a company with strong growth prospects, albeit clear business challenges ahead to iron out in 2018 with lingering black clouds over the story. That said, we believe SNAP added roughly 6 million users this quarter bringing the company to 184 million DAUs, which represents 16% year over year growth with a trajectory to exceed 200 million users during the course of 2018. ARPU will be a major focus of 4Q which we believe will grow 30%-35% YoY, although still a major Achilles heel which is well below industry norms and a front and center strategic focus going forward for Spiegel & Co as part of the app redesign.

While we believe there is modest near-term risk to SNAP's numbers, our checks with advertisers show that anecdotally speaking trends are slowly moving in the right direction as engagement, pricing, and ad load/inventory should improve during the course of 2018 as the "long overdue" app redesign helps put the SNAP train (hopefully) back on the tracks in our opinion. We note that SNAP's major overhaul of its app design and a key focus of next week's conference call will make it easier and more intuitive for new users to be attracted to the platform, as the complexity has been a clear inhibitor especially for older demographics (key advertising target market) vs. the likes of Twitter, Instagram, and Facebook. While DAU and growth remain an uphill battle, we believe heading into 2018 SNAP's multitude of newer organic initiatives (e.g. self service platform, programmatic ad model, app redesign) will start to pay dividends and stabilize growth and start to turn this story around over the coming year. That said, SNAP clearly has challenges ahead and a lot of wood to chop on its platform as well as with investors

to make sure this transition period and app overhaul leads to brighter days ahead in 2018. It all comes down to monetization in our opinion, and SNAP is going through a painful maturation phase to turn this one trick pony platform into a broader, ad centric consumer app that will enable SNAP to increase ARPU and DAU growth over the next 12 to 18 months. While Facebook remains our clear favorite social media name, we are still net positive on SNAP as the risk/reward and engagement potential still exists, although now its about the company executing and better monetizing its ~180 million DAUs in what we would characterize as a “make or break 2018” for SNAP with 4Q results/guidance the first step in this rocky road to recovery. **We maintain our Attractive rating and \$17 price target on shares of SNAP.**